

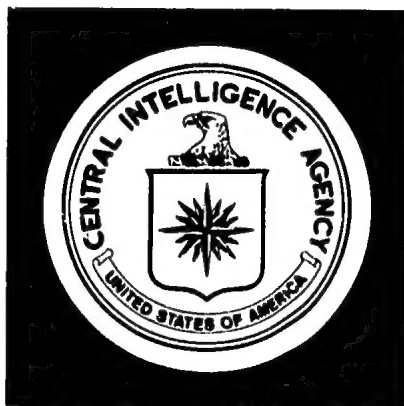
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Approved For Release 2006/04/19 : CIA-RDP85T00875R001700050059-1

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# Intelligence Memorandum

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*South Vietnam: Short-Run Economic Problems*

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ER IM 73-62  
October 1973

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**South Vietnam:  
Short-Run Economic Problems**

For South Vietnam's economy, such important projects as reconstructing war-damaged infrastructure and productive facilities, reabsorbing refugees in the economy, and overcoming a recession that has persisted since early 1972 have in recent months had to take a back seat to the more urgent day-to-day issues of rapid inflation and an almost certain impending rice crisis. Prices have increased by nearly 50% since the start of this year, while production and incomes have remained relatively constant. Rice stocks are likely to run out before the end of this year, with serious shortages expected in some localities. Popular dissatisfaction has been fairly widespread and is likely to get worse.

Although Saigon cannot solve these problems over the next several months, it feels obligated, for political and psychological reasons, to take immediate steps toward their solution. At the same time, the once-close relationship between US and South Vietnamese economic advisers has become somewhat strained as receipts from US aid and spending and the purchasing power of Vietnamese holdings of dollars decline and the government strives to formulate uniquely Vietnamese solutions to its problems. The difficulties in adjusting to reduced foreign financing, moreover, are being worsened by an internal dispute within South Vietnamese circles. Those advisers most responsible for the economic reforms of recent years – all tending to reduce controls and make the economy more responsive to natural market forces – are reportedly in a shrinking minority. Although compromises have thus far been effected in ways that nullify the most radical proposals of their opponents, a trend toward more government control of the economy is apparent.

The current economic problems will probably not overwhelm the government, but South Vietnam's policy responses to the current situation could have lasting adverse effects for longer-term economic growth and US development assistance. While the government should be able to suppress any disruptive manifestations of popular discontent, greater use of force and of direct controls would make the private sector even less cooperative. Further needed reforms in administration and tax collection would then be all the more difficult. Moreover, the private incentives that have already had substantial favorable impact on exports, domestic saving, and other key factors in development would be seriously damaged.

Note: Comments and queries regarding this memorandum are welcomed. They may be directed to [redacted]

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## DISCUSSION

### The Economy at the Cease-Fire

1. By the time South Vietnam signed the cease-fire agreement in January 1973, its economy was displaying relatively good growth prospects after years of disruption. Although the modern sector was still in recession and crop plantings were off somewhat because of the 1972 offensive, several developments and indicators augured well for the future. Inflation had slowed considerably in 1971-72; the banking system was growing rapidly, particularly in rural areas; black markets, in both commodities and currencies, had declined in importance; and, despite the increase in military activity, exports doubled in 1972 with a further doubling expected in 1973. These accomplishments provided the psychological basis of a very optimistic set of development projections presented by the South Vietnamese in April to President Nixon at San Clemente and to members of Congress.

2. The remarkable resiliency of the South Vietnamese economy during 1968-72 had been facilitated not only by large-scale US aid but also by continuous US policy advice, which was particularly instrumental in the reforms of 1970-72. These reforms provided for:

- More realistic foreign exchange and interest rates, tending to produce a more efficient allocation of financial and capital resources;
- Development of government-sponsored rural banking systems with a much wider base than in the past;
- Major tax reforms, simplifying the structure and providing for more energetic and efficient collection of domestic taxes;
- Revision of government rice-control policies to allow for increased private-sector marketing and more realistic returns for the producer; and
- The beginning of serious planning for the government's sale to the private sector of its ownership in major industrial enterprises.

3. But also at the time of the cease-fire, several factors were coming into play to make immediate economic progress exceedingly difficult. The prospects for receiving enough US aid to cover South Vietnam's import requirements at present production levels and living standards became more

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uncertain. Moreover, the value of the aid dollars was declining in real terms because of the depreciation of the dollar relative to other major currencies, and at the same time, global commodity shortages and devaluations of the piaster relative to the dollar were driving import prices up very rapidly. Added to this was the complication that assistance from other potential donors to Indochina, although extensively discussed in the world press, in most instances had not yet been committed.

4. Compounding the basic problem of a persistent industrial and commercial recession, these new developments -- many with external causes -- have raised some important questions about the long-run stability of the Thieu administration. In the course of 1973, economic problems have become more pressing as popular concern over rice availabilities, inflation, declining real incomes, corruption, and foreign aid have grown and the Thieu government has groped for effective policies.

#### **Inflation and Real Incomes**

5. In the spring of 1973, with production levels still depressed because of the 1972 offensive and ensuing uncertainty, new economic problems began to emerge. One of the most pressing was the return of serious inflation. Inflation had been a major problem since the intensification of the war and growing American involvement in the mid-1960s. The huge inflows of US spending associated with the increased American role had brought about rapid increases in incomes, money supply, and spending. Despite a sharp increase in imports of US-financed commodities, the Saigon consumer price index increased at an average annual rate of 35% during 1966-70. After two years of moderate rates of inflation (1971 and 1972), prices began rising rapidly in the spring of 1973. Unlike the past, however, this time there is not even an apparent link between increases in money supply and prices. Indeed, money supply has actually declined since January of this year.<sup>1</sup> Nor has domestic consumer or business demand been a factor. Commercial bank credit to the private sector, a rough indicator of domestic demand, has, in real terms, remained about constant through the first half of this year.

6. Security and reconstruction goals, needed reforms, and current domestic pressures have combined to require some government measures that worsened the inflation. Despite a major reform objective of reducing the huge public sector deficit, government spending -- dominated by defense payrolls -- proved difficult to cut, and the 1972 offensive added a large bill for refugee relief. To offset these problems, a concerted effort was thus made to increase revenues, primarily through more indirect taxation,

1. Even adding private savings deposits -- easily converted to cash -- to money supply produces only a 10% increase in the first half of 1973, well below the rate of inflation.

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the first-round effects of which proved inflationary. Government attempts to cut imports included devaluations and administrative increases in the official prices of many imported goods, further fueling inflation.

7. Even more important in the recent surge in prices, however, have been the unsettled conditions in world financial and commodity markets. Dollar devaluations, yen revaluations, and successive piaster adjustments have led to a wave of increases in prices for imports, which account for about one-half of the commodities sold in Vietnam's markets. During late 1972 and early 1973, these were compounded by steady rises in world prices of agricultural commodities. The Saigon retail price index for imported commodities rose more than 60% in the first eight months of this year, compared with a 40% increase in the retail price index for domestic goods. The import price of rice approximately doubled over the past year. Prices of petroleum products rose more than one-third, and those of other major US-financed imports such as fertilizer, wheat, and cotton also increased sharply. As a result of higher import prices and government action, prices of gasoline, kerosene, cement, and sugar have more than doubled since the beginning of the year.

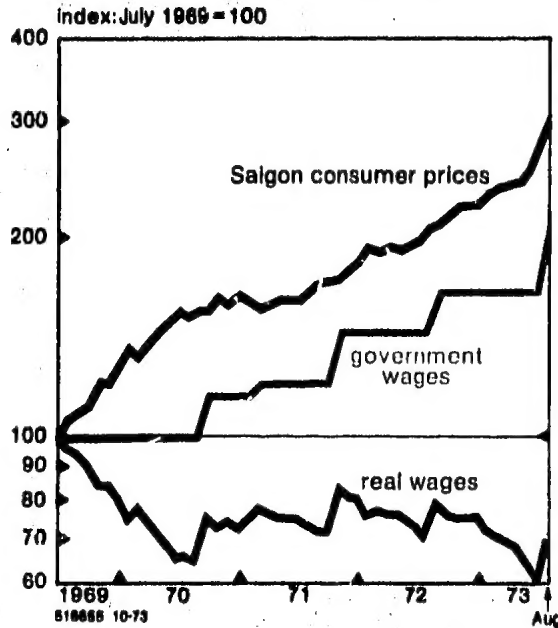
8. The effects of inflation on real incomes have been severe. In agriculture, the prices received by farmers have probably kept up with the rising costs of the goods farmers buy, so that their real incomes probably have held their own. Nonfarm real incomes have fallen, however, and those of government military and civilian employees have perhaps been hardest hit. From September 1972 through July 1973, the salaries of some 1.5 million government employees, constituting (with dependents) perhaps one-quarter of the nation's population, remained constant while consumer prices increased 38%, for a decline in real incomes of approximately one-fourth. A 25% pay raise on 4 August and an increase in the volume of subsidized goods available in the commissary were largely offset by a simultaneously announced 55% increase in the government's selling price of US rice, plus increases in official prices of petroleum products and sugar. Including the pay raise, the real incomes of government employees are still roughly 15% below those of September 1972, the date of the previous raise (see Figure 1).

### **The Rice Problem**

9. A projected rice shortage later this year has even more serious implications than does inflation for political conditions in South Vietnam. After three years of increased rice production, greater military activity and poor weather resulted in a small decline in the 1972 harvest. Continued poor weather in some areas, uncertainty as to market access, and much higher prices for fertilizers and pesticides apparently have reduced this year's

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figure 1  
**South Vietnam: Government Wages  
 and Consumer Prices**



crop as well.<sup>2</sup> South Vietnam earlier published a 1972-73 crop projection of 6.4 million metric tons; US observers now estimate a harvest more on the order of 5.9 million tons. Thus, not only have retail rice prices soared in recent months, but also, by November (just prior to the end-year harvest) there may be little rice available for the northern two-thirds of the country at any price. In late August, US officials in Saigon made the following projections of rice stocks in non-Delta areas:

	Thousand Tons
Actual	
July	120
August	122
Projected	
September	123
October	89
November	41
December	63

The November 1973 projection, representing about two weeks' supply, is the lowest end-of-month stock figure in two years (see Figure 2). More important, the December figure includes an assumption of large imports of US rice early in the month. This now appears impossible, with additional shipments from the United States not arriving until late December or possibly even January. If this is the case, stocks will run out by mid-December, or sooner if more hoarding and panic buying occurs.

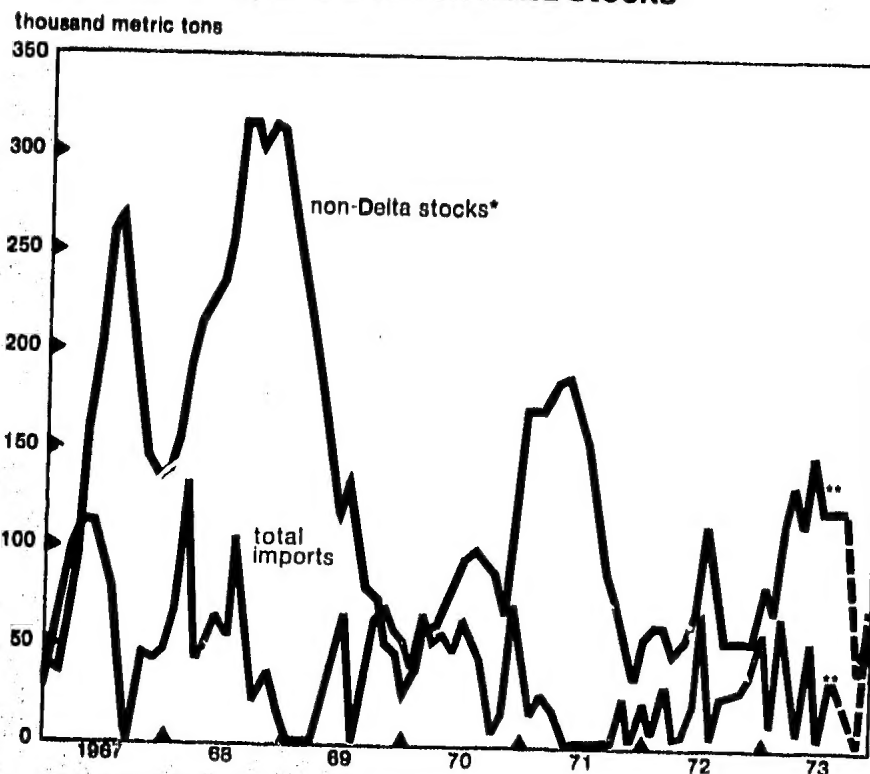
10. There has been some sort of end-of-year rice crisis in virtually every year since the mid-1960s, and the Vietnamese have been conditioned to being bailed out at the last moment. This time, however, eleventh-hour

2. Paradoxically, the recent high rice prices paid farmers may also have contributed to lower production figures than expected. In an imperfectly monetized economy, instead of providing greater production incentives, the increased cash income from a first crop may induce some rice farmers to forgo the additional work and expense required to harvest a less lucrative second crop. Another factor may be a peaking out of opportunities to increase production through the introduction of the new "miracle" rice varieties. In many countries where these varieties have been used for several years, productivity eventually begins to decline, possibly because of more general use in areas less suited to the more rigid soil, water, and climate requirements of these varieties.



**South Vietnam:  
Total Rice Imports and Non-Delta Stocks**

figure 2



\*Private and government stocks in Saigon and the northern deficit provinces (end of month).  
\*\*Projected.

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rescue appears unlikely because the world rice market is too tight to permit the additional imports until early 1974. Contributing to the shortage will be:

- A possible slowdown of Delta deliveries in anticipation of higher future prices;
- Military activity, road interdiction, or other marketing bottlenecks, which can create serious local supply problems even if the countrywide level of stocks is adequate;

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- Reported sharp increases in Communist rice purchases;
- Illegal private rice sales to Cambodia; and,
- Perhaps most important, greater speculative purchasing and hoarding resulting from increased awareness of the potential shortage.

11. Some manifestations of the impending rice problem became apparent in July. In that month, Da Nang rice prices soared and government stocks in the area were virtually depleted in an attempt to stabilize prices. A shipment of 11,000 tons in early August caused a sharp one-week decline in prices and predictions of at least short-term stability in the market. In Saigon, however, no such relief appeared in sight. On 13 August, retail rice prices were 75% higher than at the start of the year and nearly 50% higher than on 1 July. Speculative buying was being increasingly reported, as was stockpiling in the Delta as farmers and merchants held out for further price increases.

12. Some efforts to solve the rice problem are under way. On 16 August the government announced a new rice control program that includes: (1) provisions for additional sales from official stocks to government employees; (2) a ceiling for domestic wholesale rice prices; (3) a new system of province exit permits whereby private inter-province rice movements are allowed only to Saigon; (4) removal of the value-added tax on rice transactions at all levels; and (5) application of informal - but extremely heavy - pressure on Delta merchants from police and province officials to sell more rice to the government. The new measures were compromises with much more radical proposals for military-controlled collection and distribution, tighter rationing for the general public, and additional issuances of rice from government stocks at about twice the rate finally decided. In an effort to assure compliance with the agreed measures, President Thieu met with all the Delta province chiefs later in August to consolidate the control system; to improve data collection on rice prices, production, stocks, and deliveries; and to instruct officials to crack down on hoarders, speculators, or anyone selling rice to the Communists.

13. Success of the new program depends on whether it can increase significantly the quantity of rice shipped from the Delta to Saigon over the next few months and whether the government can convince the population that supplies of rice are adequate and will remain so through the rest of the year. Initial results showed some improvement. Immediately following the 16 August announcement, a relatively large increase in rice shipments was reported, and the rice market in Saigon softened a bit, with retail prices declining about 10%.

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14. The salutary effect of the new rice-control measures, however, was short-lived. Rice consumption in August was estimated to be some 15% above average levels, indicating that hoarding by consumers had begun. In addition, after about a month of stability in the rice market, Saigon retail rice prices – despite the ceilings – began soaring again in September. In sum, it appears unlikely that the government measures will turn up quantities of domestic rice sufficient to improve significantly the stock estimates noted above.

15. The government's recent measures in some respects may have weakened its defenses against future speculation and heightened the risk of strong public reaction. Greater sales from government stocks will reduce the government's maneuverability if massive speculation develops. And the price ceilings are already under great pressure, with merchants pressing for a higher wholesale price – at present lower than the price they are paying farmers. The result has been retail purchases in anticipation of further price increases. Another natural outgrowth of the situation is the recent appearance of a black market for rice – the first one in many years -- with prices now about 50% above official retail prices. The government's response was also predictable. In late September, rationing of retail purchases was started. Even tighter controls, more corruption, and marketing bottlenecks, with further public outcries over the rice issue, are almost certain.

#### Morale Problems and Public Reaction

16. Complaints of rising prices have been increasingly reported throughout the country. Thus far, however, organized protests or cohesive political action have been rare. Instead, the continuing decline in real incomes, particularly for the army personnel and civil servants, has produced further erosion of morale and an apparent increase in corruption. More military checkpoints and "taxation" have been reported, and the fact that some of the newly trained – and presumably more reliable – tax collectors were collecting a much larger fee for the value-added tax than the law required was at least one factor in its revision in early August.

17. While inflation is troublesome, the prospect of real food shortages over the next few months, especially of rice, will likely put the Thieu government to its most serious political test since its formation. It is quite possible that the government will have no rice to disburse for a month. Those in the army, the police, and the civil service and others in the government's power base will probably be able to obtain enough rice for themselves and their families. Rice will also be available to those who can bid high enough for it. Farmers, for whom Thieu has made many important concessions in recent years, will doubtless be able to provide for themselves.

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Even in urban areas, many families in Vietnam try to keep a month's supply of rice in their homes. But many of the poor, who eat little but rice and live from hand to mouth, will probably have difficulty finding substitutes that they can afford. The impact of the shortage also will vary from city to city because of a likely breakdown in distribution. Saigon is likely to have adequate supplies, for example, but other areas could be very hard hit. Further government actions could include the sacking of some government ministers, confiscation of rice, and some show trials and possible executions of speculators or illegal traders. Chinese businessmen -- long a source of envy for their energy and skill -- are likely to be singled out as scapegoats. Scattered violence or rice riots are certainly possible.

18. Because of Thieu's firm control of the military and police, the government will likely withstand the crisis. But all of this will contribute to a greater universal reaction that the government is guilty of economic incompetence. Many businessmen, for example, are upset not just with current problems but also with the transitional costs of economic reforms and the government's failure to effect a quick business recovery from the recession. Pressures on the government to deal with these problems will increase.

#### **US Withdrawal and Vietnamization**

19. The psychological impact of US withdrawal is adding to South Vietnam's difficulties in coping with its unaccustomed burden of severe economic pressures. Some of the material assistance and most of the psychological prop provided by a large US presence and frequent policy advice is now gone. Heightening government policymakers' anxieties is the realization that many South Vietnamese look to the government to provide not only policy solutions and infrastructure and reconstruction funds, but also guaranteed markets, additional protection and subsidies, and initial productive investment.

20. The Vietnamese have also been counting on greatly increased foreign investment and non-US aid to tide them over a period of declining US aid and expenditures. Although the prospects for increased capital inflows from these sources remain good over the medium and long term, hopes for immediate relief have largely been abandoned. Earlier in the year, it appeared that both Japanese and French balance-of-payments aid would be arriving before the end of this year. Now, a promised US \$50 million aid package from the Japanese, although still expected, has been delayed, probably until next year. The French are also moving slower than had been hoped, and even the \$30 million French project loan for expansion of the Ha Tien cement plant has run into some snags.

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21. The government thus feels isolated both politically and economically at a time that it is feeling heavy pressure to come up with policies to cope with inflation and rice shortages. To some extent at least, it feels it has to seek uniquely Vietnamese solutions to economic problems.

#### **Government Policy Options**

22. Important differences over economic policy and government organization are surfacing in a round of intense political infighting. The basic disagreement centers around whether the government should apply more controls and intervene more energetically in the market or whether it should rely more on natural market forces to solve the short-term problems. This has led to a rough split between the mostly older and French-educated bureaucrats -- favoring more controls -- and the primarily younger, US-educated "technocrats," who would prefer to continue the thrust of the 1970-73 reforms. Internal politics and rivalries, however, are probably more important than ideology as determinants of who belongs to what faction.

23. External pressures on domestic prices and commodity availabilities thus could not have come at a worse time for the South Vietnamese policymakers. Sympathetic to US counsel, South Vietnam had begun to set its exchange rates and to devise domestic monetary policies more in keeping with market conditions. But no sooner had these policies been implemented than inflation and rice shortages -- to a large degree outside the government's control -- undermined their support and strengthened the position of the French-trained officials who believe in import controls and exchange-rate stability.

24. The compromise decisions on the rice problem are a clear example of the strange, unstable wedding of radically different economic philosophies in the interests of political expediency. An increased government role in rice marketing will, at a minimum, probably lead to decreased producer incentives and output -- as it did in the past in South Vietnam and as it has in virtually every country where applied. Moreover, it is clearly at variance with all earlier notions published on Vietnamese development plans and will probably be poorly received by Delta farmers and Chinese merchants, two of the most important entrepreneurial groups in the nation.

25. Those advisers who are most receptive to US economic recommendations -- particularly the Minister of Economy, Pham Kim Ngoc, and the Minister of Finance, Ha Xuan Trung -- have thus far been able to head off the most radical proposals made by a group apparently led by President Thieu's closest adviser (and cousin) Hoang Duc Nha and including most of the military and several civilian advisers opposed to Ngoc and Trung. However, the positions of both Ngoc and Trung are tenuous.

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Ngoc has for several years been the architect and manager of South Vietnam's rice policies. He was relatively successful in reducing the government's role in marketing domestic rice and in allowing more realistic prices and thus cutting government subsidy expenditures. Now, largely because of circumstances beyond his control, he may become the political victim of the present rice problem. Trung's difficulties stem from his Ministry's advocacy of the ill-fated value-added tax, junked at the retail level after six weeks of widespread confusion, soaring prices (with the tax only partly responsible), and universal complaints.

26. These squabbles within the cabinet, and between cabinet members and palace advisers, have thus far had very little effect on Thieu's own position or power. Thieu's position has been strengthened as a result of the recent senate election. The Senate, in which Thieu now has more than a two-thirds majority, has in the past been one of the President's major sources of organized opposition. Because Thieu already held a wide majority in the House, the National Assembly appears certain to become a virtual rubber stamp for government legislation if he chooses to enact new economic measures via this route.

27. Thus, government policies will depend on Thieu and, more specifically, on the advisers in whom he has confidence. The signs are not encouraging. Those favoring increased controls are in the ascendancy. Their proposals include military control of rice at all levels and much more government intervention in production and distribution of other major commodities, as well as a campaign to blame Vietnam's economic problems on the Americans, the Chinese - who control much of the financial and marketing systems in South Vietnam - or the Viet Cong. A noisy campaign to blame the Communists for rice shortages and inflation has already started, and there are increasing press items critical of the Americans, French, and Japanese for renegeing on promises of increased aid. A ban on foreign investment has also been advocated by some members of the government.

### **Outlook**

28. Economic difficulties will impact strongly on the Thieu administration over the next few months, even though they are unlikely to bring down the government. In addition to the politically sensitive issues of inflation and rice availabilities, government reserves of gold and foreign exchange have fallen by nearly one-half thus far this year and at the end of August had reached their lowest level since July 1965. Clearly, the government in any event faces some months of reduced imports, and this will be compounded between now and year's end by shortages of key commodities and further inflation. Beyond these basic problems, the government may create further difficulties through extensive use of direct controls that foster black marketing and reduce producers' incentives.

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29. The outlook should brighten somewhat in early 1974. Non-US foreign aid has been promised in significant amounts for next year, and the foreign investment outlook could continue to improve. Rice imports will also once again be available as larger US exports become possible.

30. Over the longer term, economic issues will nevertheless remain a major concern. Until there are signs of revival, with increasing job opportunities and economic growth, the government will continue to face political problems arising from the economic situation. Moreover, the policies adopted to deal with present problems are palliatives that could slow economic recovery and growth and significantly lessen the prospects for additional foreign aid and investment.